INCENTIVES FOR DEVELOPERS IN NEW YORK CITY TO PROVIDE AFFORDABLE HOMEOWNERSHIP OPPORTUNITIES

by

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ABSTRACT

This thesis examines the incentives which exist for developers in New York City to provide affordable homeownership opportunities. Due to the housing crisis occurring in the New York City market, there is a scarcity of affordable units. Moreover, homeownership is declining on a national level and in the City. The implications of the lack of affordable housing and declining homeownership have far reaching effects, from neighborhood stability to the labor force.

Federal, State and municipal programs have attempted to address these issues through the development of programs to encourage participation on the part of the private sector. To some extent, the programs have been successful, however, production is not nearly meeting the demand.
Through the examination of three actual development projects in New York City, the incentives provided for developers through these programs will be discussed. Although the use of development subsidies have mitigated some of the risks to developers, the overall process and the prospect of limited profits are impediments to increased production.

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INTRODUCTION

Historically, families were able to achieve homeownership as a result of normal increases in income. In recent years, however, housing prices have outstripped earning power. The ensuing result is the young family which must wait longer to purchase their first home or by default have their choice of tenure as rental. In many cities across the nation, specifically in New York City, housing development is expensive due to the rising cost of land and increased construction costs, which are ultimately passed on to the consumer. Hence, there is an acute scarcity of affordable housing stock. In economic terms, land is going to the highest and best use as determined by the market. This appears to exclude affordable housing. The housing crisis is especially acute in New York City. This particular crisis has the capacity to jeopardize the long-term economic health of the entire city.

Both the private and the public sector have attempted to address the problem of affordable housing. Real estate developers are in business to produce a profitable product, in this case housing. Affordable housing by definition would require the developer to sell his product at a below market rate. Without government intervention this would not be a profitable venture for the developer. Hence, the production incentive would be removed.

The purpose of this thesis is to examine the issue of existing incentives for developers in New York City to provide affordable homeownership opportunities. Chapter I of the thesis gives an overview the New York City housing market, explores the arguments surrounding the need for affordable housing in the City, as well as the importance of homeownership. In Chapter II, there are descriptions of Federal, State and municipal programs created to encourage production of affordable homes. These descriptions outline the mechanics of the programs, and identify the incentives for developers that are provided under each program. Chapter III discusses some of the risks inherent in real estate development and the incentives for a developer to assume that risk. Chapter IV analyzes the impact of the previously described programs through actual case studies of affordable homeownership development, including project specific data. In the conclusion, there is a summary of the effectiveness of these incentives and recommendations for improvements.

CHAPTER I

AFFORDABLE HOUSING: AN OVERVIEW

To be able to afford something by definition, "is to meet the expense without serious consequences."[1] Generally, affordable housing is clean and decent housing that can be acquired for a reasonable percentage of a buyer's income. Housing occupancy is either in the form owning or renting. While this thesis will focus on the affordability of homeownership, the topic must be evaluated in the context of a buyer's decision which is the cost of homeownership relative to the cost of renting.

There are two general statistical trends which describe the problem of affordable housing. First, is the trend in the level of homeownership costs relative to household income. Second, is the trend in the level of homeownership costs relative to the costs of renting.

On a national level, the cost burden of homeownership has increased from approximately 10.64% of household income in 1979 to approximately 30.22% of household income in 1985, the most recent year data is available.[2] As might be expected, homeownership rates are declining, particularly in younger age groups. Since 1980, homeownership as a percentage of the total population has fallen every year, for a total drop from 65.6 to 64.1 percent.[3] While this overall decline appears minor (a 1.5 percent decline over a five year period), a more significant statistic, is the decline of homeownership for younger households. For households in the 25-29 age segment there was a 4 percent decline, from 41.7% in 1981 to 37.7% in 1985.[4]

The cost of homeownership relative to the cost of renting bears examination. Over the 1980-1983 period, the median rent burden (rent plus heating payments as a percentage of household income) rose from 27% in 1980 versus 29% in 1983, a 7.4 % increase.[5] This compares to an increase in the cost of homeownership index (basically financing charges plus home related expenditures) of over three times during the same period (from 10% in 1979 to 34% in 1983).[6] This disparity in costs has influenced the overall growth in total households which rent. Between 1980 to 1983 the overall growth in households was 6 percent. The share of households that rent has increased from 34.4% to 35.3% over the same time period.[7]

"The current cost of owning a home is largely determined by the purchase price of the home and the mortgage interest rate, which together determine monthly mortgage payments."[8]

As a result, the proportionate share of income needed to purchase a home and service a mortgage has increased. Housing prices on average are higher across the country, due in part, to increases in construction costs . Higher house prices in turn contribute to not only higher mortgage payments but higher downpayments on houses as well. Moreover, in recent years buyers have been particularly vulnerable to interest rate volatility in residential mortgages. Because home prices and mortgage interest rates have risen faster than household income, they have exacerbated the affordability issue.[9]

Income eligibility is a measurement used to determine whether or not a household will qualify for a mortgage. The ratio represents monthly housing expenses to monthly household income. Income eligibility ratios are based on income representing total gross household income before taxes, and housing costs reflecting monthly payment of mortgage principal, mortgage interest, property taxes and mortgage insurance. Historically, Savings and Loan institutions have been the primary providers of residential mortgages. Data gathered by Savings & Loan institutions suggest that statistically, households devoting more than 30 to 35 percent of their income to debt, all types of debt combined, have a higher risk of mortgage default. These findings have become an industry standard, and have led quasi-public agencies, such as the Federal National Mortgage Association (FANNIE MAE), to adopted even more stringent and conservative standards. Fannie Mae, which purchases, repackages and sells mortgages for the secondary market, in most cases requires that monthly housing expenses do not exceed 28 percent of income.[11]

With a population of slightly more than seven million people, the New York City housing market reflects national housing affordability trends. According to a recent New York Times article, the average price of a new house in the Northeast region is slightly above $120,000.[12] Assuming a family devotes 28% of their income to housing and obtains a conventional 30 year mortgage, at an interest rate of 10 percent, this translates into a family income of roughly $50,000 to purchase a house. In the New York City metropolitan area, the average price of a previously occupied house is $140,000[13], approximately 17 % higher than average prices for new homes in the Northeast region. Only 8 percent of the families in the metropolitan region have incomes over $50,000, leaving 92% with incomes below $50,000. These statistics coupled with an average income of $26,000 for residents of New York City, suggests that a large portion of the population is excluded from owner occupied housing.[14]

A general contributing factor to the rise in homeownership costs is the availability of mortgage credit. Rising interest rates tend to lead to larger downpayments because they usually signal higher levels of inflation and hence, higher housing prices. Households must have higher incomes or put forth larger downpayments to meet the income eligibility requirements of lenders. Consequently, the costs of homeownership are onerous for many households and they decide not to purchase.[15]

The increase in the use of adjustable rate mortgages was in response to the affordability problem of homebuyers which was caused by higher levels of interest rates in the early 1970's and early 1980's. These mortgages, by providing lower initial interest rates help homebuyers to qualify for mortgages due lower monthly payments resulting from lower interest rates.[16]

Because of high construction costs, developers tend to build luxury rental units where there is potential to command the highest market rents. The median contract rent in New York City according to a 1984 survey is $330 (including utilities).[17] This relatively low median rent reflects the wide range of rents in the city and is indicative of a very fragmented market. The highest rents in the city are found in Manhattan, south of 96th Street, where the median rent is $476, and asking rents are estimated at above $1,000. As well, the median rent figure includes the 177,282 apartments in public housing projects. The median rent in these dwellings is $160.[18] These figures account, in part, for the disparity in the perception of New York City as a high rent city. However, the median rent does not indicate the availability of apartments as measured by the prevailing vacancy rate. The net vacancy rate, in 1984, for New York City apartments was 2.04 percent, down from 2.13 percent in 1981. Despite the low median rent, the rent to income ratio in the city was 29.3 percent as of 1984, an increase from 28 percent in 1981.[19]

In addition, rent control and rent stabilization are primarily responsible for the relatively low median rent, because they keep rents below the market rate. Rent control applies to residential buildings constructed before February 1947 in municipalities that have not declared an end to the post-war rental housing emergency. For an apartment to be under rent control, the tenant must have been living there continuously since before July 1st, 1971. When a rent control apartment is vacated it either becomes rent stabilized or is completely removed from regulation.

Buildings are under rent stabilization if they were built between February 1947 and January 1974. Rent stabilized apartments have increases tied to fluctuations in the economy. Rent Control limits the rent a landlord may charge for apartments and restricts the right of a landlord to evict tenants. A developer must either wait for tenants of rent controlled buildings to move or buy them out. By contrast, a developer of commercial property only has to wait until existing leases expire.[20]

High housing prices, increases in the cost of new construction and depressed rents due to rent control contribute to the decision regarding what type of housing a developer provides. The previously mentioned factors in addition to the high cost of land, provide incentives for developers to supply the high end of the market. The result is low production of truly affordable housing and by contrast, substantial production in the luxury end of the market.

Homeownership is a determining factor in neighborhood stability and is evidence of economic investment in a community. Moreover, homeownership is a key factor in transformation of deteriorating neighborhoods. For example, the purchase of solidly constructed, but deteriorated homes in neglected areas, and subsequent rehabilitation, is considered gentrification. By definition gentrification is the transformation of a deteriorated neighborhood. New York contains many distressed neighborhoods. For various reasons, economic development and investment in some of these areas has ceased. The provision of affordable homeownership opportunities in these neighborhoods would have a dual impact, to spur economic investment and promote neighborhood stability.

The need for affordable homeownership opportunities goes beyond the issue of neighborhood stability, especially in urban areas such as New York City. On a national level, arguments for affordable homeownership focus on first time homebuyers. A more critical issue to the economic viability of urban areas, particularly, New York City, is the question of affordable housing for middle/moderate income workers. Families in the $25,000-$48,000 income range, whether or not they are first time homebuyers, are the backbone of the labor force, because they supply support services to businesses. In a recent New York Times article, a leading accounting firm announced its intentions to move its operations outside of the city. The reason cited was that the company's workers could no longer find affordable housing within a reasonable commute.[21] Usually the decision to relocate outside of the city is due to rising commercial rents. This segment of the labor force is being disenfranchised from the housing market, particularly if their choice of tenure is to own. Hence, the provision of affordable homeownership opportunities at lower costs to middle/moderate income groups is important in order to encourage this segment of the labor force to remain in the City.

Aside from the importance of homeownership to neighborhood stability and labor force access, there are also the social benefits implied by homeownership to consider. Homeownership is a central part of the American dream, as such it has become a valued symbol of independence and success. Americans expect to work hard and through normal and expected increases in income be able to achieve the goal of owning their own home. "For them, homeownership represents financial security, comfort, privacy, the freedom to adapt a dwelling to individual and family needs, and the intangible sense of belonging to a community."[22]

CHAPTER II

FEDERAL, STATE AND MUNICIPAL PROGRAMS

The following is a description of some of the programs available on the Federal, State and Municipal level to provide affordable homeownership opportunities:

THE NEW HOMES PROGRAM UNDER THE NEW YORK CITY PARTNERSHIP

The New Homes Program is administered by The New York City Partnership, with municipal assistance provided by The New York City Department of Housing Preservation and Development. The New York City Partnership (The Partnership) is a private organization, composed of business and civic leaders concerned with pertinent issues affecting the City as a whole. The intent of the New Homes Program is to "Provide homeownership opportunities for moderate- and middle- income families in the $25,000 - $48,000 income range, who have been priced out of the New York City housing market."[23] Under the current program, approximately 1200 homes have been completed.[24]

Basically, the developer enters into an agreement with The Partnership to act as the builder of the units. Consequently, he agrees to build, design and finance the project, and assume the risk this entails. The developer, now builder agrees to build the project for a guaranteed maximum cost, which less public subsidies represents the affordable sales price. Moreover, the developer agrees to limit his profit to 10 percent of the total development costs, less any public subsidies and contingency costs. Hence, any cost overruns are the sole responsibility of the developer and can potentially reduce his profit.[25]

The majority of the Partnership projects are built on City-owned land. The potential site is conveyed from the City to The New York City Housing Development Fund Company,Inc., (The Fund), a non-profit entity. The Fund is in direct contract with the developer to build and market the project. Because of The Fund's non-profit status (as an Article XI corporation), the structure of the deal exempts the developer from paying mortgage recording tax on the construction loan, sales tax on construction materials, state property transfer tax and capital gains transfer tax. The New York City transfer tax is 1% of the sales price of the unit. The State property transfer tax is equal to .04% of the sales price of the dwelling unit. The sales tax on construction materials is equal to 8% of the hard cost building materials. The mortgage recording tax is computed as 1 % of the face amount of the mortgage. The capital gains transfer tax is usually computed as 10% of the developer's profit on a single family home or condominium unit.[26]

The developer does not own or hold title to the site. The Fund, as the actual owner of the site, mortgages its fee interest in the site to the lender on behalf of the developer, so that the developer can obtain financing without title. The City conducts an independent appraisal of the site to determine the value of the parcel. At this point, The Partnership assigns a value to the site, of $500 per unit constructed on the site. Based on the number of units built on the site, this becomes the developers assigned acquisition costs. The lowered acquisition cost is in fact a subsidy in favor of the developer. The difference between the appraised value of the site and the developer's acquisition cost becomes a lien on the property assumed by the homebuyer. The lien is over a fifteen year period and diminishes 1/15th for every year the unit is held. The lien is repaid by the buyer out of resale proceeds at the time the unit is sold. These factors work in conjunction not only to lower the sales price of the homes to the eligible buyers but to lower the acquisition cost to the developer.[27]

Two sources of public funds are combined to provide subsidies for this program. Federal monies are available in the form of Urban Development Action Grants (UDAG's) up to

$15,000 per unit. For every $1 of UDAG funds in the project there must be $3 of private investment capital. Funds are also available from the New York State Affordable Housing Corporation (AHC) up to $15,000. Subsidy contributions from AHC cannot exceed 40 percent of the total project cost. These funds are administered and disbursed through the Partnership. City Assistance funds are also available up to a limit of $10,000 per unit. Total subsidies from public sources for projects participating in the New Homes Program cannot exceed $25,000 per unit.[28]

Lenders familiar with the program, provide construction financing, typically requiring personal guarantees from the developer for construction completion. More importantly, lenders will accept the public subsidies as proxy for equity participation from the developer. Hence, the developer can put forth lower amounts of equity capital than in a regular project. However, the developer continues to be "at risk" for the entire amount of the construction loan and subject to interest rate fluctuations.[29]

The obligation for the repayment of these subsidies is passed onto the homebuyer in the form of a lien on the property. The lien is non-amortizing and non-interest bearing. If owner occupancy exceeds fifteen years, the lien is removed and the loan is forgiven. Otherwise, the loan is repaid from 50 percent on the gain on the property at resale. The homeowner is required to have the unit as his principal residence. If the home is resold within three years the next buyer must meet the income eligibility guidelines of having an income under the $48,000 limit. After the three year period, any buyer can purchase the home whether or not their annual income is below $48,000. However, liens are repayable by subsequent buyers, if they meet the income eligibility guidelines the lien is assumed by the new owner. If the new owner has an income above $48,000 the lien is repayable at the time of the resale.[30]

The proceeds from the sale of the units repay the construction loan which has the first position of any borrowed funds. The developer and The Partnership are paid monies owed for non-subsidized development costs. The developer can then deduct the limited profit which may or may not equal 10 percent of the project costs less subsidies. City Assistance funds, UDAG funds and AHC funds are paid, in that order.[31]

In addition, the Partnership offers technical assistance to developers who participate in the New Homes Program. Technical assistance funds are available through a cooperative agreement between the Department of Housing and Urban Development (HUD), and The Partnership. Funds of up to $25,000 are available to developers for soils analysis, surveys and preliminary design schematics. As well, The New York State Division of Housing and Community Renewal provides seed loan money to developers participating in the program for up front costs , such as architectural and legal fees. This loan is a zero- interest loan that is given prior to the construction commitment , with repayment expected from the construction loan. All funds are administered through The Partnership.[32]

SECTION 235 PROGRAM

Section 235, began in 1980 as the original component of the City's homeownership program. Projects have been built in all boroughs except Staten Island. A critical component of the 235 Program is the Mortgage Subsidy Program, administered through HUD, which enables families with incomes under $35,000 , who otherwise would be ineligible, to purchase homes. Sales prices of section 235 homes are limited by the program guidelines to $57,000 for a three-bedroom home and $66,000 for a four- bedroom home. The Section 235 Program is currently being phased out due to Federal cutbacks. To date, the program has produced approximately 1100 homes.[33]

Section 235 homes are constructed on City owned parcels. Developers are selected through a Request For Proposal(RFP) process, by which a developer is chosen to complete a project. For projects begun before 1986, the acquisition cost was $500 per unit built on the parcel. For projects begun after 1986, the acquisition cost is the appraised value of the parcel. Similar to the Partnership program the difference between the acquisition cost and the appraised value is payable by the individual purchaser at the closing of his home or assumed as a lien in the case of income eligible purchasers. The designated developer designs, builds and finances construction of the homes through a loan from a private construction lender. Section 235 homes are built for a fixed sales price, not to exceed the sales price caps described above. Subsidies are awarded from the City providing up to $15,000 per unit in City Assistance, and for homes built after 1986, up to $13,500 per unit in combined UDAG or AHC funds. A lien is placed on the units equal to the amount of the construction subsidy. The lien is the responsibility of the homebuyer to be paid when the home is resold. Houses built under the Section 235 program are available to anyone able to afford the costs of owning a home which translates into families which are approved for a mortgage by a conventional lender. The single requirement is that the units remain owner occupied.[34]

BRONX NEW HOMES PROGRAM

The Bronx New Homes Program, similar to the New Homes Program, aims to provide homeownership opportunities for a moderate income target market. At present, the program has produced over three hundred units in several sites in the Bronx. The project is designed for single family attached homes, in the $70,000-$80,000 price range. At least ninety percent of the units are targeted for sale to families with incomes below $48,000.[35]

Developers are selected through the Request for Proposal process. The selected developer acts as the builder, and is responsible for design, construction and financing the project. The acquisition cost of the land is $500 per unit built on the parcel. City Assistance subsidies are available, for $15,000 per unit. The subsidy is allocated in payments during the construction phase. Upon completion and sale of the homes to purchasers, the remainder of the land price is payable. The subsidy derived from City Assistance funds convert into liens on the property similar to those described under The New Homes Program.[36]

Several State of New York Mortgage Agency (SONYMA) mortgages are available for New Homes units. At present,homes built under the program are entitled to the 421b tax abatement. The tax abatement allows homeowners to initially pay property taxes on the land alone. After three years, taxes on the house are phased in. At five years, the homeowner will pay approximately half the fully assessed property taxes with the full assessment paid after the eighth year.[37]

NEHEMIAH

The Nehemiah Program is administered by a coalition of East Brooklyn Churches known as the Nehemiah Plan. The program was founded in 1982 to build single-family row houses in the Brownsville and East New York sections of Brooklyn. The objective is to provide affordable housing for people in the moderate income bracket. Both two and three bedroom units are sold for $43,500. Roughly 2,000 homes are in various phases of production under the program. The low sales prices are attributable to several factors. The City of New York has made large acreage available for $1.00 per dwelling unit. In addition, City Assistance is available in the amount of $10,000 per dwelling unit. The City has agreed to complete street paving and other infrastructure work in the public right of way.[38]

Nehemiah further benefits from a large private grant which is used by the developer as an interest-free loan during the construction phase. Because these are very large sites, development costs and in turn purchase prices, can be reduced significantly by economies of scale.[39]

The Nehemiah development process is different from the process in the other programs in several respects. The Coalition of East Brooklyn Churches contracts with the city for a license to build on City - owned land. Construction financing is provided from a private interest free revolving fund obtained from contributions from the coalition members. Site preparation, including demolition and removal of rubble is completed by the City. City Assistance funds are available in the amount of $10,000 per unit. Upon completion, the subsidy serves to reduce the sales price to $43,500. After the sale of the units the City Assistance subsidy becomes a permanent lien on the property .[40]

Neither State nor Federal Subsidies are utilized in Nehemiah homes. All units have a State of New York Mortgage Authority (SONYMA) set-aside which guarantees all purchasers mortgages at SONYMA rates, currently 9.2%. In addition, Nehemiah units are entitled to a twenty year tax abatement. "Under this abatement, homeowners are obligated to pay only the pre-existing land tax for the first ten years of occupancy. After the tenth year, taxes on the home are phased in gradually until the 20th year, at which time the exemption ends and the property is taxed at its fully assessed value."[41]

OTHER SOURCES OF PUBLIC SUBSIDIES

DEPARTMENT OF HOUSING AND URBAN RENEWAL

Federal cutbacks have clearly been evident in affordable housing programs which came under the auspices of The Department of Housing and Urban Development (HUD). Since the advent of these cutbacks, HUD's previous contributions have been curtailed. However, HUD is still the source for Urban Development Action Grants (UDAG's) which provide subsidies for affordable homeownership. Through the NYC Partnership and the Department of Housing Preservation and Development, HUD grants are available to designated projects for technical assistance, such as site feasibility analysis.[42]

URBAN DEVELOPMENT ACTION GRANTS

As previously mentioned, Urban Development Action Grants are available to partially finance development costs. A maximum of $15,000 per unit is provided by HUD. There must be at least $3 of private investment for every $1 of UDAG funds in the project. The funds are disbursed as work is completed, based on a predetermined leverage ratio. Benefits are derived from UDAGs in the form of zero-interest subordinate financing, which is attractive to both the developer and to the conventional lender in the project. The benefit to the end user is in a reduced purchase price due to the subsidies.[43]

AFFORDABLE HOMEOWNERSHIP PROGRAM

During the 1985 session, the State Legislature established a subsidiary corporation of the Housing Finance Agency (HFA), the Affordable Housing Corporation (AHC). AHC, administers the Affordable Home Ownership Development Program. "The purpose of the Affordable Home Ownership Program is to promote homeownership by persons of low and moderate income. AHC provides financial assistance, in conjunction with other private and public investment, for the acquisition, construction and rehabilitation and improvement of owner occupied housing. By reducing development and rehabilitation costs, the assistance provided is expected to make homeownership affordable to families and individuals for whom there are no other reasonable and affordable home ownership alternatives in the private market. Additionally, the development and rehabilitation activities undertaken in connection with this program are expected to help improve blighted neighborhoods, or those in danger of becoming blighted. It is also expected to create jobs and stability in communities throughout the State. Eligible applicants under the program are municipalities, housing development fund companies or any not-for-profit corporation or charitable organization which has as one of its primary purposes the improvement of housing."[44]

Funds are also available from the New York State Affordable Housing Corporation,(AHC), to partially finance development costs. Guidelines similar to those applicable to UDAG funds exist, in that there must be $3 of private investment for every $1 of AHC funds in the project. Again, funds are disbursed again as work is completed, based on a predetermined leverage ratio. No more than 50% of the grant funds can be used in a single municipality. As well, grant awards cannot exceed $15,000 per unit or 40% of the total project cost, whichever is less.[45]

STATE OF NEW YORK MORTGAGE AGENCY

The State of New York Mortgage Agency (SONYMA) is a public benefit corporation formed in 1970 to provide affordable housing for New York State residents. SONYMA offers below market rate mortgages through the sale of tax-exempt revenue bonds. Proceeds from the sale of these bonds are used to purchase mortgages originated by a network of participating lenders statewide. In 1983, under Governor Cuomo, the mission of the agency was changed in order to provide New Yorkers with better affordable housing opportunities. The mortgage loan program, renamed the Affordable Housing Program, began to center on "forward commitments" made by the agency to purchase new, below market rate mortgages from lenders instead of the old method of purchasing seasoned mortgages. Hence, creating a more immediate secondary market for residential mortgages. SONYMA mortgages are available to purchasers of existing and newly constructed homes at a fixed rate for a maximum of thirty years with a minimum 5% down payment. Beneficiaries of this program must be first-time homebuyers, except in targeted, economically distressed neighborhoods (where the first-time homeowner requirement is waived).[46]

CHAPTER III

DEVELOPER INCENTIVES

The role of the developer in any real estate project is analogous to that of a producer of a motion picture. He is the pivot for all the components of the project. In the absence of the developer or the producer there is no vision of what the end product can be, moreover there is no strategy to realize that vision. The developer is responsible for the coordination and negotiation of the project. These responsibilities include site identification and feasibility analysis, acquisition, financing, construction, marketing and sales. The skills involved draw from a wide range of disciplines, from engineering and architecture to finance and law. The developer is the consummate negotiator and organizer. He has to rely on the capabilities of other tradesmen to complete his project. There is a great deal of teamwork involved. For team work to be productive and cost - effective, the developer must be able to communicate his desires to the team members. He must be able to assess objectively and realistically the abilities of the team members, and ensure that they can fulfill his vision of the project. One of the keys to success in the real estate business is project management. Every detail of the project must be adequately addressed.

At every point in the development process there is some element of risk. The risks of a project are often times interrelated. There are different types and magnitudes of risks, which all impact the potential profitability of a project. A large part of the developer's decision to undertake a project, is the amount of risk he is willing to assume. Success depends on the ability to identify, assess and control the risks inherent in a project. There is construction risk, financing risk and absorption risk. The result of the subsidy provided by homeownership programs is to shift the burden of some of these risks from the developer.

The intent of the programs is to increase the production of affordable housing and make the product available to the target market. The intent is achieved by the use of subsidies. The effect of the subsidy is to mitigate a portion of the developer's risk in the project. Moreover, the subsidies reduce the price of the units to the homebuyer, thus, satisfying part of the intent of the program. When the risks in a project are diminished, an incentive exists for the developer to consider going forward with the project. The result, should then be increased production of affordable housing, meeting the original objective.

Subsidies are applied to the most risk sensitive areas of the development process, acquisition, construction, and financing. The structure and mechanics of the programs are similar, they subsidize the risks of the project. As demonstrated in the case studies, acquisition costs of available and buildable sites are lowered through subsidy applications. In unsubsidized development, acquisition costs usually equal the appraised value of the property. The subsidy defers a portion of the cost of the land by attaching a lien on the property which defers payment of the remainder of the appraised value until the unit is resold.

Subsidies are also directly applied to costs during the construction phase. These subsidies are in the form of a non-interest bearing contribution to the construction loan. Repayment of this subsidy comes from profits realized from resale of the unit by the buyer. Aside from their contribution to these costs, the primary benefit of the subsidy is that lenders will accept it as proxy for equity in construction financing. As a result, in the case studies relatively little equity was put forth by the developers.

In addition, during the construction phase there is always the risk of construction cost overuns. Developers must demonstrate the capacity to build and finance the project, prior to designation. All of the developers have development experience, however every project must be managed individually to control costs and deliver the project on schedule. Those who participate in these programs are confident that based on their experience, they have the capacity to control costs. In this instance, cost control is key to affordable housing construction because the developer's profit is limited. Therefore, cost overuns would have a negative impact as deductions from their profits.

The structure of the program also allows for the waiver of certain municipal and state "taxes" because title is never passed directly to the builder. This structure exempts the builder from mortgage recording tax on the construction loan, state property transfer tax, tax on construction building materials, and the capital gains transfer tax.

Due to the time factor involved in development, the developer has the additional risk that by the time his product is completed, the market is soft. If absorption rates are below his original projections, he may not be able to command the prices he had anticipated. This risk is alleviated by participation in affordable housing programs where historically there has been a waiting list of potential applicants that exceeds the number of units available. For example, a recent project by The New York City Housing Partnership has 594 apartments and a waiting list of 5,000 families.[47] A captive market exists where demand exceeds supply.

Developers also participate in the program in order to gain experience and establish credibility. As discussed, the risks involved in conventional development have been mitigated as an incentive for the developers to participate in the program. Herein lies an opportunity for the developer to refine and practice his craft in a somewhat sheltered environment.

Participation in the program also allows a developer to establish contacts and familiarity in working through the City approvals and permitting process. In future projects the developer in all likelihood will negotiate with the same politicians and city bureaucrats. Knowing how to expedite a project through this process is a cost savings because of the construction loan interest the developer is accruing.

As construction costs rise developers seek new and innovative methods to reduce these costs. Attempting to lower costs with prefabricated modules and simpler design prototypes has become an alternative for builders. Again, the construction of affordable housing provides an appropriate backdrop for the builder to test design prototypes, in an effort to control costs.

Real estate development is fraught with risks. Again, the objective of affordable housing programs is to increase the production of such housing by private sector developers. Although the program endeavors to mitigate the risk to the developer, the trade-off is a limited profit for the developer. For the limited profit, the developer obtains lower risk. However there is another opportunity cost to accepting these types of projects. For every affordable housing project the developer accepts with the promise of a limited profit he forgoes other projects.

The opportunity cost for a real estate developer to build and develop affordable homes is high. Real estate development is inherently a high risk business. For a developer to undertake risk, reward must be the trade-off. A balance is struck between the amount of risk assumed and the subsequent reward which compensates the developer for undertaking that risk. Developers who participate in public subsidy programs to provide affordable housing must usually limit their profit to some extent. In the case of the New Homes program the developers profit is limited to 10% of total development costs. If total development costs are higher than originally projected then the developers profit will be less. Conversely there is no incentive for the developer to deliver the project below cost since profit is limited to 10%, he cannot realize any cost savings.

The amount of risk the developer must undertake for a limited profit may be the same as the amount of risk assumed in a project where the profit is not limited. Although the programs described in this thesis attempt to mitigate a portion of the developer's risk, in essence the developer is still responsible for construction loans and subject to interest rate fluctuations during the time period the loan is outstanding. The developer acts as the builder, however he does not hold title to the land. The developer, despite the clever and complex structure of these programs, assumes a great deal of risk.

CHAPTER IV

CASE STUDIES

As has been suggested, in order to promote private sector production of affordable housing programs must offer concrete and quantifiable incentives to the developers. The programs described have attempted to provide incentives for developers through direct and indirect subsidies. Direct subsidies as applied, lower the acquisition and construction costs. Indirect subsidies are derived in the form of a waiver of municipal taxes on costs, specifically land and construction materials. The programs promote the building of affordable units by attempting to mitigate the risks the builder is exposed to during the normal development process. Diminished or controlled risk is the incentive for developers presented by the programs. In addition, the developer realizes a profit, limited to 10 percent of the development costs less any subsidies and contingency costs.

The following section describes how selected programs in the New York City market have achieved the desired results, stimulating the private sector to provide affordable housing. Moreover, the analysis attempts to determine the contribution and impact of the subsidies provided by the programs.

Both the Woodhaven Project and the proposed Flatbush Condominiums fall under the auspices of the New Homes Program, administered by the New York City Housing Partnership. Phase V of the Columbia Terrace Project is the last phase of housing in The Columbia Street Urban Renewal Area. This project is being developed under an agreement between the builder and The New York City Department of Housing Preservation and Development, utilizing City Assistance Funds. The initial phases of the project were completed under the Section 235 Program before its demise.

FLATBUSH CONDOMINIUMS

The Project

The project located in the Bushwick section of Brooklyn, consists of 72 units of new construction in the form of condominium units in twenty-four three story buildings. The project is being developed in conjunction with The Holy Cross Church, Catholic Charities of Brooklyn & Queens, and under the auspices of The New Homes Program sponsored by The New York City Partnership. The Holy Cross Church has contributed 90% of the site to the project, with the remaining 10% coming from the City. Title to the land held by the Partnership, the "right" to build is conveyed to the developer who then becomes a contract builder.[48]

Development Objectives

The New Homes Program specifically targets utilization of distressed sites, which otherwise would not be economically feasible. To achieve this goal, use of the site in the program and subsequent development of the site must be profitable for the developer. The builder/ developer sought to realize a reasonable return, (10% was satisfactory). The partnership which is developing this site includes a builder/contractor. One of the objectives of the builder is to test design prototypes that might prove cost efficient for future projects. Because the partnership includes an experienced contractor, as developers they are confident they can control costs. This point is critical to the profitability of the project and their decision to participate in the New Homes Program. Any cost over runs are the responsibility of the developer/builder and consequently erode potential profits. In addition, this is the development partnership's first project in the New Homes Program. An underlying reason for their participation in the program was to gain experience and develop expertise in working with city agencies through the development process. This type of experience is invaluable in terms of familiarity with the city approval process and contacts within the bureaucratic system.[49]

Project Summary

Prices for the 72 units were determined by the per square foot development costs before the subsidy was applied. This method enabled the developer to basically determine the sales price for the units. The projected unit mix is for 24 two - bedroom apartments and 48 three-bedroom units. After determining the per square foot costs and the number of square feet in each unit type, the developer arrived at a base price. The public subsidy on a per unit basis was subtracted from the base price of each unit for a subsidized sales price. This base price was adjusted for various amenities, for example, parking spaces and direct access to the unit.[50]

The developer's price estimates for the units are in the following chart:

TYPE	First Fl.	Second Fl.	Third Fl.	UNITS
Two BR	$84,400	$82,500		13
Two BR(P)	87,400	85,500		11
Three BR	95,000	93,500	91,000	25
ThreeBR(P	98,000	96,500	94,000	23

TOTAL $8,015,300

Analysis of Pro Forma

Total revenues from the sale of the units are projected at $8,015,300.(refer to Exhibit 1) The total development costs of the project are estimated at $7,436,383. The key components of the total development costs are land

FLATBUSH CONDOMINIUMS

DEVELOPMENT PRO FORMA

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	TOTAL COST	PERCENT OF TOTAL	PER SQ. FT.	PER UNIT
LAND COSTS				
Land Aquisition	$207,500	2.79%	$2.85	$2,882
Site Costs	230,400	3.10%	3.17	3,200
Excavation/Fill	115,200	1.55%	1.58	1,600
Sub Total	553,100	7.44%	7.61	7,682
CONSTRUCTION COSTS				
Foundation	280,800	3.78%	3.86	3,900
Masonry	806,400	10.84%	11.09	11,200
Carpentry	1,440,000	19.36%	19.81	20,000
Electrical	237,600	3.20%	3.27	3,300
HVAC	394,200	5.30%	5.42	5,475
Plumbing	367,200	4.94%	5.05	5,100
Roofing	115,200	1.55%	1.58	1,600
Other Costs	978,336	13.16%	13.46	13,588
General Cond.	493,000	6.63%	6.78	6,847
Sub Total/Hard Costs	5,112,736	68.75%	70.33	71,010
DEVELOPMENT COSTS				
Arch./Eng.	175,000	2.35%	2.41	2,431
Legal/Acct.	90,000	1.21%	1.24	1,250
Sales/Mktg.	95,000	1.28%	1.31	1,319
Insurance	150,000	2.02%	2.06	2,083
Taxes	7,500	0.10%	0.10	104
Misc.	1,047,775	14.09%	14.41	14,552
Sub Total/Soft Costs	1,565,275	21.05%	21.53	21,740
MISCELLANEOUS CONTINGENCY	205,272	2.76%	2.82	2,851
TOTAL DEVELOPMENT COST	7,436,383	100.00%	102.29	103,283

PROFITABILITY	
Total Revenues From Sellout	$6,550,605
Public Subsidy	$1,464,500
	============
	$8,015,105
Less Total Development Costs	$7,436,383
Developer's Fee	578,722
Subsidy Percentage Contribution	19.69%

Source: Author's calculations per figures provided by developer of Flatbush Condominiums, Alan Bell and Nick Lembo, June 19,1987 acquisition, hard (construction) costs, and soft costs for preliminary fees such as architecture and legal expenses. This reflects land acquisition costs of $207,500,(2.79% of total development costs). Construction costs were $5,112,736 (68.75%), and soft costs were $1,565,275, reflecting 21.05% of total development costs.[51]

The subsidies in this project lowered the land acquisition costs and the cost of construction. By virtue of the structure of The New Homes Program, the acquisition cost of the land from The City of New York was substantially lowered. As described in the Program description the land was conveyed to the developer for the price of $500 per unit built on the parcel, amounting to $3,000. The difference between the appraised value of the parcel and the amount paid ($24,500) becomes a non-amortizing, non-interest bearing lien on the property distributed over the total number of units in the project. As well, The Holy Cross Church has agreed to defer a portion of the land acquisition payment equalling $155,000 , to be repaid from the proceeds of the sale of the units. The effect of this subsidy is reflected in the acquisition cost of 2.79 percent of the total cost which appears to be relatively low. The public subsidy of $1,440,000 was applied to infrastructure and hard construction costs. The application of the subsidy to the construction costs had a substantial impact because construction costs made up 68.75% of total development costs. In addition there is an implied subsidy from the savings derived from the tax waiver. The New York City transfer tax is 1% of the sales price of the unit. The State transfer tax is equal to 4/10ths of 1 % of the sales price of the dwelling unit. The sales tax on building materials is equal to 8% of the hard cost building materials. The mortgage recording tax is computed as 1 % of the face amount of the mortgage. The capital gains transfer tax is usually computed as 10% of the developer's profit on a single family home or condominium unit. These costs are quantifiable and constitute a subsidy benefit to the developer. Because the developer does not hold title to the site under the New Homes Program, he is not subject to these taxes.

As mentioned in the previous chapter, the developers fee of $578,722 is calculated as 10 percent of the total development costs minus subsidies and contingency costs, and in this case, is less the $155,000 of Church owned land.

The significant impact of the subsidies are evident if the subsidy is considered as a percentage of the total development cost. In the case of the Flatbush Project the subsidy contribution as a percentage is @ 20 percent. This constitutes a substantial contribution to the profitability of the deal. Without the subsidies available through this program this project would not have been economically feasible.

WOODHAVEN ESTATES

The Project

Woodhaven Estates consists of 10 two-family detached homes located on a previously City owned parcel in the Woodhaven section of Queens. The project was completed in January 1985. All ten homes were sold prior to completion of the project. The units of @ 1,144 sq.ft. each, are intended for single family occupancy with an income generating rental tenant unit. Rental units are common in this area of Queens, moreover, "as of right" zoning permitted this configuration. The owner occupied unit has a small unfinished cellar which gives it additional space. This project was initiated under the New Homes Program in conjunction with The New York City Partnership.[52]

Eligible purchasers, as per the income guidelines of the program, could not have a family income which exceeded $48,000. The homes were sold for $125,000 a piece with required downpayment of 10%. A mortgage at 10%, with a 30 year term, and a 10% downpayment would require a higher income than the limit of $48,000. However, the income generated from the rental unit, estimated as $600 using market comparables, when applied to the monthly housing payment enabled the buyer to have a lower income.[53] The market value of the homes was estimated by the developer to be $175,000.

The designated developer for Woodhaven Estates is a builder/contractor, originally an architect by training. Initially, the parcel was offered for sale through an auction conducted by the Department of Real Estate of the City of New York. The minimum bid for the parcel started at $60,000 with no takers at this price. The Woodhaven area is primarily an owner-occupied residential neighborhood. Citing the absence of a bid as an indicator, the developer deduced that this site was not "economically feasible" for conventional development and therefore an excellent candidate for the New Homes Program.[54] The low bid was indicative of reluctance on the part of builders to undertake the risk of the project. The risk being that development of the parcel would not yield substantial returns, despite the surrounding neighborhood. After two years of lengthy negotiation, the parcel was released to the New York City Partnership for use in the New Homes Program.

Project Summary

The prices for the homes in Woodhaven Estates were derived as a function of the cost of development. Total development costs on a per unit basis were approximately $159,000 prior to any public subsidy. A per unit public subsidy was applied of $35,000 , resulting in subsidized sales price of $125,000. The subsidy in this project appears high. This fact is due to the configuration of the homes which allows for two units per home, entitling the developer to separate subsidy consideration for each unit, as opposed to each home. The project was completed during a fifteen month time frame. Actual construction was completed in nine months. By January of 1985, a list of potential buyers was closed to further applicants. Within a three month time period the project was completely sold.[55]

Developer Objectives

The developer of Woodhaven Estates is primarily a developer of luxury homes and condominiums in the Long Island area. Woodhaven Estates was an earlier project in the developer's career, which aided in the establishment of his track record as a developer. As a result of his experience with the Woodhaven project, in 1986 he will develop 39 units in the Bushwick section of Brooklyn. In this instance his incentive is portfolio balance relative to his other projects. As a developer of luxury units in Long Island the development of affordable housing is a stark contrast. The market for luxury units is precarious, as well the construction is vulnerable to interest volatility. As an experienced builder, he feels confident costs can be controlled and the project will be delivered on time. However, the market for luxury units is subject to absorption rate changes. Absorption rates may differ from the outset of the project to the end of the project. As previously cited, the demand for affordable housing is strong. If his experience with the sellout of Woodhaven Estates is replicated in Bushwick, the capacity for the absorption of affordable units in the market will demonstrate the demand for affordable housing. The structure of the projects under the New Homes program offer the developer a profit limited to 10% if cost over runs can be controlled. In addition, his "core crew" of laborers are assured employment in the event the market for luxury units is soft. The developer has scheduled his projects accordingly, anticipating he will be able to do luxury building and affordable housing. The workers on both these projects are the same, if there is a need for additional labor, they are hired out of the contingency cost of the project. The subsidies he received as the designated developer were accepted by his construction lender as his share of equity in the project.[56]

Pro Forma Analysis

Total development costs for the project were $1,488,070, which included land acquisition and site costs of $321,320, representing 21.59% of total development costs, construction costs of $847,500 (56.95%) and Soft costs of $198,450 (13.34%).(refer to Exhibit 2) Total acquisition costs for the project were $77,000 representing 5.18% of the total cost of the project. Relative to a subsidized acquisition cost of 2.79% of total development costs in the Flatbush project, this figure is high. The acquisition costs of this particular parcel were not subsidized by the New Homes Program. As previously stated, prior to 1985, the guidelines for the program stated that land acquisition costs were carried at appraised value. However, City Assistance Funds in the amount of $70,000 or $7,000 per unit, were applied to infrastructure costs. Without this subsidy substantially higher Land/Site costs would have been incurred, bringing the percentage to 26.30% of total development costs . The effect of the subsidy is reflected in the lower 21.59% of total development costs.

Hard construction costs for the development of the ten homes constituted 56.95% of total development costs. The

THE WOODHAVEN PROJECT

DEVELOPMENT PRO FORMA

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	TOTAL COST	PERCENT OF TOTAL	PER SQ. FT.	PER UNIT
LAND COSTS				
Land Aquisition	$77,070	5.18%	$3.37	$7,707
Site Costs	114,250	7.68%	$4.99	$11,425
Excavation/Fill	130,000	8.74%	$5.68	$13,000
Sub Total	321,320	21.59%	$14.04	$32,132
CONSTRUCTION COSTS				
Foundation	85,000	5.71%	$3.72	$8,500
Masonry	70,000	4.70%	$3.06	$7,000
Carpentry	75,000	5.04%	$3.28	$7,500
Electrical	47,000	3.16%	$2.05	$4,700
HVAC	40,000	2.69%	$1.75	$4,000
Plumbing	80,000	5.38%	$3.50	$8,000
Roofing	25,000	1.68%	$1.09	$2,500
Other Costs	385,500	25.91%	$16.85	$38,550
General Cond.	40,000	2.69%	$1.75	$4,000
Sub Total/Hard Costs	847,500	56.95%	$37.04	$84,750
DEVELOPMENT COSTS				
Arch./Eng.	13,000	0.87%	$0.57	$1,300
Legal/Acct.	12,000	0.81%	$0.52	$1,200
Sales/Mktg.	10,000	0.67%	$0.44	$1,000
Insurance	5,000	0.34%	$0.22	$500
Taxes	3,000	0.20%	$0.13	$300
Misc.	155,450	10.45%	$6.79	$15,545
Sub Total/Soft Costs	198,450	13.34%	$8.67	$19,845
MISCELLANEOUS	319,250			
CONTINGENCY	120,800	8.12%	$5.28	$12,080
TOTAL DEVELOPMENT COST	1,488,070	100.00%	$65.04	$148,807

PROFITABILITY	
Total Revenues From Sellout	$1,250,000
Public Subsidy	$350,000
	============
	$1,600,000
Less Total Development Costs	$1,488,070
Developer's Fee	111,930
Subsidy Percentage Contribution	23.52%

Source: Author's calculations per figures provided by developer
Leslie J.Lerner, Woodhaven Estates, June 23,1987

bulk of the public subsidy was applied to these building costs. Total soft costs were 13.34% of total development costs. The effect of the waiver of specific property and sales taxes, is demonstrated by taxes contributing less than a third of one percent to total costs.

Total revenues constituted $1,250,000 for ten homes sold at $125,000 each. The developers fee of $101,700, was calculated as 10 percent of the total development costs minus the subsidies and the contingencies. The overall effect of the subsidy on the project is recognized by calculating the subsidy percentage contribution to total development costs. Almost a quarter, 23.52%, of the total development costs were paid for by the subsidy. In this case, without the subsidy the homes might have been able to command a market price igher than the per unit cost of production, depending on the faith of the potential purchasers in the attributes of the neighborhood. However, it is clear that these homes would not be affordable to families within the $25,000 to $48,000 income bracket. The subsidy therefore, actually lowered the purchase price of the home for the target market.

COLUMBIA TERRACE

The Project

Columbia Terrace is a 180 unit residential condominium project located in Carroll Gardens section of Brooklyn. The project is built on a site originally owned by The City of New York, and developed under the Section 235 program before it was phased out. The developer of the project was designated through the Request for Proposal process, to build a mix of affordable and market rate residential condominiums. The site was zoned for residential and commercial use and the ensuing development was constructed "as of right". The initial three phases, completed by 1984, sold out almost immediately. These first three phases had approximately 40% moderate/affordable units and roughly 60% market rate units. There were buyers for both types of units, buyers qualified for the moderate rate units if total family income did not exceed $48,000. Phase IV of the project, comprised of only market rate units is in the midst of a normal six-month sell out period. Phase V, which is the focus of this case study, is currently being negotiated. The figures used in this case study are hypothetical figures prepared as a basis for discussion in the negotiation process, and do not at all reflect the ultimate outcome of the process.[57]

Project Summary

The terms for the structure of the agreement for the development of Phase V of Columbia Terrace are under negotiation. The proposed structure of the deal is not final and will in all likelihood undergo extensive changes. It is included in these case studies for purposes of illustration. For a project of this large a scale it is not unusual for the development and construction to be phased in segments. Phasing is used when there is market uncertainty as to whether or not the project will sell. Prior phases of the project were developed under the Section 235 program. In early 1986, some of the guidelines under the program were revised before Section 235 was phased out altogether. Since the demise of Section 235 , the developer has been negotiating solely with The Department of Housing Preservation and Development for subsidies from the City Assistance Fund.[58]

Under the revised Section 235 program, after 1986, all parcels developed under the program were sold at their appraised value. As described in a previous under the program guidelines, at least 40 percent of the total number of units in the project have to be affordable units. The City will share in the profits derived from the sale of the market rate units. The City and the developer are negotiating the projected market price of the units, any profits from which they will share. The actual amount of the subsidy payment from the city is also being negotiated.[59]

Development Objective

At the time this project was undertaken by the developer it was the largest project he had ever developed. As well it provided the opportunity to develop a large parcel at what the developer felt, was an acceptable level of risk. Subsidies were being provided during the construction phase such that the developer had to put forth a relatively minimal amount of equity. Moreover, the construction lender accepted the subsidy payment as an equity contribution towards the construction loan. The developer as standard procedure gave personal guarantees for the project. The developer was and continues to be an active developer in the Brooklyn area. He saw an opportunity to develop a large site, (which are not commonly available) in an area where he was already established. The developer was familiar with the area and felt confident that the project would sell.[60]

Analysis of Pro Forma

Total revenues are estimated to be $3,928,000. Revenues are derived from the sale of the units at the following prices:[61]

TYPE	PRICE	UNIT	TOTAL
Efficiency	$69,000	2	$138,000
One BR	89,000	6	$534,000
Two BR	109,000	8	$872,000
Two BR/Market	149,000	16	$2,384,000
TOTAL		32	$3,928,000

Total development costs for the entire project are estimated at $4,361,473.(refer to Exhibit 3) The total development costs include the land acquisition at, $163,000,(3.74%) total hard costs of $2840,800 (65.13%) and soft costs representing $480,883(11.02%). Land acquisition costs constitute 3.74% of total costs. The $163,000 purchase price for the land reflects the full appraised value of the property, which is allowed under the program guidelines. Construction costs are estimated at approximately 65.13% of total development costs. The subsidies from the City will make up a portion of these construction costs. Soft costs

COLUMBIA TERRACE
DEVELOPMENT PRO FORMA
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	TOTAL COST	PERCENT OF TOTAL	PER SQ. FT.	PER UNIT
LAND COSTS				
Land Aquisition	$163,000	3.74%	$5.09	$5,094
Site Costs	342,750	7.86%	$10.71	$10,711
Excavation/Fill	250,000	5.73%	$7.81	$7,813
Sub Total	755,750	17.33%	$23.62	$23,617
CONSTRUCTION COSTS				
Foundation	140,400	3.22%	$4.39	$4,388
Masonry	403,200	9.24%	$12.60	$12,600
Carpentry	720,000	16.51%	$22.50	$22,500
Electrical	115,300	2.64%	$3.60	$3,603
HVAC	192,100	4.40%	$6.00	$6,003
Plumbing	184,100	4.22%	$5.75	$5,753
Roofing	75,100	1.72%	$2.35	$2,347
Other Costs	485,163	11.12%	$15.16	$15,161
General Cond.	525,437	12.05%	$16.42	$16,420
Sub Total/Hard Costs	2,840,800	65.13%	$88.78	$88,775
DEVELOPMENT COSTS				
Arch./Eng.	187,493	4.30%	$5.86	$5,859
Legal/Acct.	48,000	1.10%	$1.50	$1,500
Sales/Mktg.	160,000	3.67%	$5.00	$5,000
Insurance	55,000	1.26%	$1.72	$1,719
Taxes	6,300	0.14%	$0.20	$197
Misc.	24,050	0.55%	$0.75	$752
Sub Total/Soft Costs	480,843	11.02%	$15.03	$15,026
MISCELLANEOUS	765,300	17.55%	$23.92	$23,916
CONTINGENCY	284,080	6.51%	$8.88	$8,878
TOTAL DEVELOPMENT COST	4,361,473	100.00%	$136.30	$136,296

PROFITABILITY		SUBSIDIZED	
Total Revenues From Sellout	$3,928,000	Total Revenues	$2,016,000
Public Subsidy	$472,000	Public Subsidy	$472,000
	============		============
	$4,400,000		$2,488,000
Less Total Development Costs	$4,361,473	Development Costs (Subsidized Units)	$2,180,737
Developer's Fee	38,527		
Subsidy Percentage Contribution	10.82%	Developer's Profit	$307,263
		Subsidy Percentage Contribution	23.41%

Source: Author's calculations per preliminary figures provided by developer, Frederick W. Hilles of Columbia Terrace, June18, 1987 are 11.02 % of total development costs. In this case study the developer's fee is not limited to 10 percent of the total development costs, therefore total revenues less costs represent the developer's profit. Under this scenario the developer's fee on the subsidized units would be $307,263. However, these figures are used to illustrate the effect of the subsidy.

Actual impact of the subsidy should only be evaluated against the portion of the project that is subsidized. The subsidy contribution is 23.41% of the affordable income portion of the project. If the project is negotiated under these terms the contribution of the subsidy is substantial. According to the developer the subsidy figures are also being negotiated.

CHAPTER V

CONCLUSIONS

The objective of homeownership programs is to increase production of affordable housing by the private sector, for a targeted population. The implication of making homeownership affordable is that it must be subsidized in some manner to lower the purchase price for the buyer. An implication of increased production is that some incentive is being provided for developers to produce this type of housing. Regarding the former issue, these programs have provided ample subsidies for homebuyers such that purchase prices under these programs are substantially below market prices for comparable units. With regard to the latter issue, the case studies sited in this thesis provides evidence of production by the private sector. Whether this level of production is sufficient to meet demand is an unanswered question.

The affordable homeownership programs in New York City have provided clean, decent and affordable units. Provision of affordable homeownership opportunities has been possible under these programs because of the contribution of the subsidy to the projects and program's ability to mitigate a portion of the risk inherent in the development process. More importantly, the subsidy also lowers the cost of the home to the purchaser. As evidenced in each of the case studies, the pro forma analysis indicates that the subsidies made at least a 20 percent contribution to each of the projects. Without the subsidy contribution it is doubtful that the projects would have been undertaken. The subsidies contributed to the lower acquisition costs of the land and served as equity in construction loans. Basically, the application of subsidies helped to mitigate some of the risks of the project. In the Flatbush Condominium project the subsidy contribution was 19.69%. to the overall project. For Woodhaven Estates, the subsidy contributed 23.52% towards the project. Moreover, the subsidies in these two projects help to decrease the purchase price to the homebuyer. These three features of the programs made the provision of affordable homeownership opportunities possible.

Despite the attributes of the programs, further examination indicates that their structure has a limited appeal to developers. This illustrates the opportunity cost in the decision making process of each developer. As the developer considers an affordable housing project, he must also consider the projects he forgoes. He weighs financial risk he must assume in the project versus the profit he earns which compensates him for taking that risk. These are the issues which must be resolved before a developer is willing to undertake an affordable housing project. Hence, the developer will go forward with a project if the profit compensates him for the risk. Since the profit scheme under affordable housing programs are limited the developer will often opt for a more lucrative project.

While there are limited benefits to participation in the housing programs, in addition, the programs entice developers who fall in a select category. The program attempts to mitigate some of the risks of the project in exchange for the developer accepting a limited profit. The programs provide a development opportunity which includes lowered acquisition costs, subsidies which qualify as equity in the construction loan, a strong market for the product, and building and development experience. Aside from these attributes, the developer's who participate tend to have additional motives. In the Woodhaven Estates project and Flatbush Condominiums these projects represent the first large undertaking for the development entity. In the case of the developer of Columbia Terrace, aside from participation in the Section 235 program there was the opportunity and experience to develop a large tract of land that would otherwise not be available. To developers who are establishing themselves or entering a different phase of their careers these programs offer experience, a forum in which to test design ideas and establish contacts in the development community. Consequently, as a developer's career progresses these motivations become less important.

There are several approaches to broaden the appeal of these programs. First, change or modify the features of the existing programs. Existing programs can be modified to increase the mix of affordable units and market units in a project. This change would provide a greater profit motivation for the private sector developer through the sale of the market rate units. Moreover, the weakness of these programs is the limited profit relative to the risk the developer must assume. A better balance between the risk the developer must undertake under these programs and the potential profit would be an added incentive. In addition, perhaps larger scale projects could be encouraged where possible,to provide the developer some economies of scale and therefore cost savings. Larger scale projects would also increase the number of units produced as well as provide greater profit potential. These modifications would make the structure of these programs more attractive to developers, hence, increasing production of affordable homeownership opportunities.

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[48]Alan R. Bell and Nicholas Lembo of Flatbush Condominiums, interview by the author, 19 June 1987, Brooklyn, New York.

[49]Ibid.

[50]Ibid.

[51] Author's Calculations

[52]Leslie J. Lerner of Woodhaven Estates, interview by the author, 23 June 1987, Brooklyn, New York.

[53]Under the New York City Partnership guidelines, normally income eligible buyer's could not have incomes which exceeded $48,000. Due to the unique configuration of the 2-family homes available in Woodhaven Estates, one owner-occuppied unit and one rental unit, the guidelines were relaxed. The Partnership agreed to accept up to 75% of the annual rental income generated by the unit as an addition to the homebuyers income. This modification allows the buyer to afford the higher priced house.

[54]Ibid.

[55]Ibid.

[56]Ibid.

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[58]Ibid.

[59]Ibid.

[60]Ibid.

[61]Ibid.